



STATE OF WASHINGTON

OFFICE OF FINANCIAL MANAGEMENT

Insurance Building, PO Box 43113 • Olympia, Washington 98504-3113 • (360) 902-0555

December 12, 2001

The Honorable Gary Locke, Governor
Members of the Fifty-Seventh Legislature
State of Washington
Olympia, Washington 98504

In accordance with Chapter 43.88.027 of the Revised Code of Washington, the Office of Financial Management has prepared this COMPREHENSIVE ANNUAL FINANCIAL REPORT of the state of Washington for the fiscal year that ended June 30, 2001.

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the state. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the various funds and account groups of the state. All disclosures necessary to enable the reader to gain an understanding of the state's financial activities have been included.

The report is presented in three sections: Introductory, Financial, and Statistical. The Introductory Section includes this transmittal letter. The Financial Section begins with the Independent Auditor's Report and contains the general purpose financial statements, notes to the financial statements, required supplementary information, combining financial statements, schedules for account groups, and other schedules. The Statistical Section includes selected financial, economic, and demographic data.

The state provides a wide range of services. These include education, social, health, transportation, environmental, law, public safety, resource and recreation development, public improvement, and general administrative services. The accompanying report includes all funds and account groups of the primary government, the state of Washington as legally defined, as well as all of its component units. Component units are legally separate entities for which the primary government is financially accountable. The determination of "financial accountability" is based on criteria established in Governmental Accounting Standards Board Statement No. 14. Note 1.A to the financial statements explains more fully which organizations are included in the reporting entity.

Governmental Structure

The state of Washington was created by an enabling act of Congress in 1889. The state is located on the Pacific Coast in the northwestern corner of the continental United States. Washington comprises 68,139 square miles and currently has a population of 5.8 million. Washington is famous for its scenery of breathtaking beauty and sharp contrasts. On the west side of the state, high mountains rise above coastal waters. The forests of the Olympic Peninsula are among the rainiest places in the world. Washington's coastline has hundreds of bays and inlets that make excellent harbors. In the eastern part of the state, the flat semi-desert land stretches for long distances without a single tree.

Washington's location makes it a gateway for land, sea, and air travel to Alaska and the Pacific Rim countries. Ships from all parts of the world dock at Washington ports. The Boeing Company, a leading producer of commercial airliners and spacecraft, has plants in Auburn, Kent, Renton, Everett, and Spokane. Microsoft, a leader in the computer software industry, makes its home in Redmond. The Weyerhaeuser Company, a major producer of wood and related products, is headquartered in Federal Way. Costco Wholesale Corporation, headquartered in Issaquah, operates an international chain of membership warehouses.

East of the Cascade Mountain Range, farmers raise livestock and wheat on large ranches. Washington leads the nation in apple production. The state produces large amounts of lumber, pulp, paper, and other wood products. The mild moist climate in western Washington makes the region excellent for dairy farming and the production of flower bulbs.

The state currently receives about 58 percent of its income in governmental funds from taxes and 28 percent from federal grants. The main tax sources are retail sales taxes, business and occupation taxes, property taxes, and motor fuel taxes.

As established in the State Constitution, the state consists of three branches of government: the Executive Branch, the Legislative Branch, and the Judicial Branch. The Executive Branch has nine elected officials as follows: the Governor, Lieutenant Governor, Secretary of State, State Treasurer, State Auditor, Attorney General, Superintendent of Public Instruction, Commissioner of Public Lands, and Insurance Commissioner. Forty agency heads are appointed by, and report to, the Governor. Eighty-eight agency heads report to a board appointed in whole or in part by the Governor. The Legislative Branch consists of two legislative bodies: the Senate consisting of 49 members, and the House of Representatives with 98 members. The Judicial Branch consists of the State Supreme Court which is the highest court in the state comprised of nine Justices. Every two years, three Justices are elected for six-year terms. A Chief Justice is chosen from among the most senior Justices.

Economy and Revenue Outlook

Fiscal Year 2001 proved to be an average year for Washington State's economy. Employment grew by 2.3 percent, about the same as Fiscal Year 2000 but more than a percentage point below employment growth rates in Fiscal Years 1997 and 1998. The aerospace industry continued to reduce jobs, but the pace of the employment decline slowed in Fiscal Year 2001. Real personal income slumped significantly by 1.2 percent, a rate almost four percentage points below the growth rates recorded in the prior three fiscal years.

More important for Washington's outlook is that Fiscal Year 2002 is expected to bring the first recession to the state in eighteen years. Wage and salary employment in Washington is forecast to decline in Fiscal Year 2002. This decline reflects the national recession and the additional job loss in the state's aerospace sector due to weakened air carriers and the substantial decline in air travel after the events of September 11th.

Real personal income growth is predicted to remain low as stock option income continues to decline after the stock market dropped. Recovery in Fiscal Year 2003 is expected to be weak both in terms of employment growth and growth in real personal income. General Fund-State revenues are expected to decline slightly in the 2001-03 Biennium compared to the 1999-01 Biennium due mainly to the recession. The decline also reflects the impact of non-economic factors, especially voter approved initiatives, which include property tax cuts and transfers of revenue from the state's General Fund to dedicated education funds.

Economic Condition in Fiscal Year 2001

Washington's wage and salary employment grew at the rate of 2.3 percent in Fiscal Year 2001, slightly slower than the US wage and salary employment growth rate of 2.5 percent. Washington's growth rate was similar to its wage and salary employment growth rate of Fiscal Year 2000, but significantly less than the 3.8 percent growth in Fiscal Year 1998 and 3.9 percent growth in Fiscal Year 1997. Despite the deceleration in employment growth more than 37,000 new jobs were added in Washington State in Fiscal Year 2001.

Although the wage and salary employment growth rates of the state and nation moved at very similar levels during Fiscal Year 2001, personal income in Washington grew by only 3.7 percent compared to national growth of 6.6 percent. Real per capita income rose by 1.2 percent in Washington over the same period as compared to 4.0 percent for the nation. For the previous five fiscal years, personal income growth in Washington exceeded US growth by substantial margins.

The main reason for the slowdown in personal income growth was the performance of the software sector where the value of exercised stock options plummeted with the retrenchment in high technology, internet and computer and software stock prices. Stock option income is a larger proportion of Washington State personal income than for US personal income. Excluding the impact of the decline in software stock options on personal income, there would have been only a very slight slowdown in personal income growth in 2001 and Washington personal income growth would have been about the same as US growth.

Aerospace employment was a major factor in the year's slowdown in employment growth. After adding more than 15,000 employees in Fiscal Year 1998, employment in the aerospace industry fell by 3,400 in Fiscal Year 1999 and 17,800 in Fiscal Year 2000. Aerospace employment continued its decline in Fiscal Year 2001, falling by 3,200. Just as the aerospace employment decline began to abate in Fiscal Year 2001, a host of other manufacturing industries went into decline. Manufacturing employment in Washington declined by 11,200 jobs in Fiscal Year 2001, a reduction of 3.1 percent. Non-manufacturing employment slowed to a pace of 2.1 percent growth, much slower than the 3.2 percent to 3.5 percent growth of the last four years.

Employment in durable manufacturing other than aerospace fell by 3.3 percent in Fiscal Year 2001, while employment in durable manufacturing nationally declined by 0.9 percent. Within this sector of the state economy, employment increased in electrical machinery (6.6 percent), which includes electronic and electrical equipment. Employment in instruments manufacturing grew by 0.6 percent. All other durable manufacturing industries experienced declining employment during Fiscal Year 2001. The largest percentage declines occurred in transportation equipment, down 11.3 percent (decline of 1,800 jobs), and primary metal industries, down 10.1 percent (loss of 1,200 jobs). Other than aerospace, the largest absolute decline in employment took place in lumber and wood products where 2,200 jobs were lost (a 2.2 percent decline). Durable manufacturing excluding aerospace declined by 4,900 jobs in Washington in Fiscal Year 2001.

Non-durable manufacturing employment in Washington decreased by 2.8 percent in Fiscal Year 2001, a loss of 3,100 jobs. Nationally, non-durable manufacturing employment declined by 2.3 percent. In Washington, all six non-durable manufacturing industries experienced employment losses in Fiscal Year 2001. The largest percentage losses in employment occurred in apparel, 10.6 percent decline, and miscellaneous non-durable manufacturing, 4.0 percent loss. Employment in printing and in chemicals both declined by 1.8 percent and employment in pulp and paper fell by 3.6 percent. Employment in food and kindred products decreased by 1.3 percent.

Non-manufacturing employment increased by 2.1 percent during Fiscal Year 2001, led by transportation, communications and public utilities employment growth of 3.6 percent, and services growth by 3.5 percent. Retail trade employment and wholesale trade employment grew by 1.2 and 1.9 percent respectively, while employment in construction rose by 1.6 percent. Employment growth was slowest in finance, insurance and real estate employment, 0.4 percent, and state and local government employment, 0.9 percent.

Federal government civilian employment declined by 1.8 percent in Fiscal Year 2001, reflecting the release of temporary workers hired for the 2000 Census.

Economic Outlook

The economic forecast for Washington State for Fiscal Years 2002 and 2003 reflects the recession most economists believe is currently in progress at both the state and national levels. According to the November 2001 forecast by the state Economic and Revenue Forecast Council (ERFC), growth in Washington's wage and salary employment is predicted to fall by 0.9 percent in Fiscal Year 2002, with practically no growth (+0.1 percent) in Fiscal Year 2003. Washington's employment performance is expected to be slightly below national employment growth for the next two fiscal years. National employment growth is forecast to fall by 0.4 percent in Fiscal Year 2002 and increase by 0.3 percent in Fiscal Year 2003.

Personal income growth in Washington State is also expected to grow more slowly than the national average for Fiscal Years 2002 and 2003. The ERFC economic forecast indicates that personal income in Washington will grow by only 1.8 percent in Fiscal Year 2002, slower than the 3.1 percent growth expected for US personal income. However, Washington personal income growth is predicted to rebound to 3.7 percent in Fiscal Year 2003. This compares favorably to the nationwide projection of 4.0 percent growth in personal income for the same period.

Manufacturing employment in Washington is projected to continue its decline into Fiscal Years 2002 and 2003, due to the national recession and the effects on the air travel industry from the events of September 11th. The ERFC estimates that aerospace employment will decline by another 3,600 workers in Fiscal Year 2002. Reflecting the expectation of reduced aircraft orders from financially strapped airlines, aerospace employment is predicted to decline by 15,000 in Fiscal Year 2003. Other manufacturing sectors are expected to decline by about 17,100 in Fiscal Year 2002 but rebound somewhat with losses of about 2,200 jobs in Fiscal Year 2003.

In the non-manufacturing sectors, the strongest growth is predicted to occur in services. Services employment is forecast to expand by only 0.3 percent in Fiscal Year 2002 but rebound significantly with 3.1 percent growth in Fiscal Year 2003. Finance, insurance and real estate employment growth is one of the few bright spots during the next two fiscal years. In the non-manufacturing sector along with services and the federal government, it is forecast to increase employment in both Fiscal Year 2002 and Fiscal Year 2003. Employment in finance insurance and real estate is predicted to increase by 0.8 percent in Fiscal Year 2002 then accelerate to 1.1 percent growth in Fiscal Year 2003. Federal government civilian employment is forecast to grow by 1.8 percent in Fiscal Year 2002 and 0.8 percent in Fiscal Year 2003.

Retail trade employment is forecast to decline by 0.8 percent and wholesale trade employment by 1.8 percent in Fiscal Year 2002, again reflecting the effects of the recession. Retail trade employment should show very modest growth of 0.2 percent in Fiscal Year 2003, but wholesale trade employment will continue its decline by falling 0.8 percent. Construction employment is expected to fall substantially as residential construction slows due to the recession. Construction employment in Washington is predicted to fall by 3.7 percent in Fiscal Year 2002 and 2.2 percent in Fiscal Year 2003. Employment growth in transportation, communications and public utilities employment is predicted to decline by 0.8 percent in Fiscal Year 2002 but increase slightly, by 0.2 percent, in the following fiscal year. State and local government employment is expected to grow by 1.5 percent Fiscal Year 2002 but decrease by 0.7 percent in Fiscal Year 2003 as budgets are pinched by the recession and slow revenue growth.

General Fund-State Revenues

General Fund-State revenues for the 2001-03 Biennium are forecast to be \$21.2 billion, a decrease of 0.3 percent in nominal terms over the previous biennium. When adjusted for changes in tax policy and inflation, revenues are expected to grow at a rate of 0.7 percent in the 2001-03 Biennium. General Fund-State revenues adjusted for policy and inflation increased by 7.2 percent in the 1999-2001 Biennium. The adjusted revenue growth rate for the 2001-03 Biennium is the slowest since the recession of 1981-83, when revenues (after adjustment for inflation and policy changes) declined by 7.2 percent.

Flat revenue growth in the 2001-03 Biennium reflects the slowing state economy due to the national recession and the financial and economic effects of the events of September 11th. The reduction in aerospace employment is a major contributor to the general slowing in the state economy, especially coming on the heels of almost three years of prior reductions. In addition, Washington voters approved two initiatives to the people, Initiative 747 and Initiative 773, which reduce General Fund-State revenues by \$34.1 million in the 2001-03 Biennium.

Initiative 747 limits the growth in regular property tax levies to one percent per year. Local property tax districts with a population of ten thousand or fewer must limit property tax levy increases to one percent per year, unless the voters of the district approve by a simple majority vote an increase greater than this limit. The state property tax levy may increase only by the lesser of one percent per year or the rate of inflation. Initiative 747 does not apply to voter approved special levies, such as local school levies.

Initiative 747 was approved by Washington voters and will take effect for property taxes due in calendar year 2002. The property tax limitation in Initiative 747 will reduce General Fund-State revenues by \$25.1 million in the 2001-03 Biennium. The impact on the General Fund-State is relatively minor since the state property tax levy was already limited to growth at the rate of inflation as measured by the US Implicit Price Deflator for Personal Consumption. Local regular property tax districts that have relied on levy growth rates closer to the 6 percent limit for local regular districts before Initiative 747 was passed will experience significant revenue reductions from property taxes.

Initiative 773 raises the tax on cigarettes by 60 cents for a 20-cigarette pack, effective January 1, 2002. The Initiative also increases the surtax on the wholesale price of tobacco products from 74.9% to 129.4%, effective January 1, 2002. The new revenues from these two tax increases are deposited in the Health Services Account, a non-General Fund-State Account, to be used mainly in the Basic Health Plan to supplement, not supplant, the level of state funding to support an enrollment level of 125,000 each year. Currently, 23 cents of the state's cigarette tax of 82.5 cents is deposited in the General Fund-State. The large increase in the cigarette tax from 82.5 cents per pack of twenty to \$1.425 per pack will significantly reduce consumption and sales. The reduced consumption of both cigarettes and other tobacco products due to the large increases in both taxes is estimated to reduce General Fund-State revenues by \$9.1 million in the 2001-03 Biennium.

Based on the economic forecast, projected growth in General Fund-State revenues, and the impact of voter approved Initiatives, the Economic and Revenue Forecast Council, in its November 2001 forecast, reduced expected revenues by \$813 million. The state is now expected to receive \$21.209 billion in General Fund-State revenues for the 2001-03 Biennium, compared with \$22.022 billion estimated in September.

Based on the November 2001 revenue forecast, appropriations adopted in the 2001-03 Biennial Budget would exceed available General Fund-State resources (General Fund-State revenues plus reserves) by \$747 million. The Emergency Reserve Fund, which contains revenues received by the state in excess of the Initiative 601 expenditure limit, is projected to have \$384.3 million by the end of the 2001-03 Biennium after all required money transfers and expenditures are made.

As a result of these projections and earlier indications that revenue growth was slowing, the Governor has already taken actions to remedy the situation:

- (1) Large agencies supported by the General Fund were asked to submit 15 percent budget reduction options.
- (2) All agencies with General Fund-State support were encouraged to examine activities that could be postponed or streamlined, and to limit hiring to critical positions.
- (3) A 2002 supplemental budget recommendation is being developed to rebalance revenues and expenditures for the 2001-03 Biennium.

The state's Budget, Accounting and Reporting System Act (RCW 43.88.110(8)) only mandates Governor-directed allotment reductions as necessary to "prevent a cash deficit" during the fiscal period. Since the Legislature has an opportunity to revise the current budget in January, an allotment reduction does not appear necessary at this time.

Major Initiatives

Washington continued its multi-year effort in Fiscal Year 2001 to improve the state's public education system, make state government more efficient and responsive, promote economic development, and protect and make wiser use of natural resources. Governor Gary Locke and the Legislature also laid solid groundwork for legislation to greatly improve the state's transportation system.

Public Education

Governor Gary Locke's top priority – improving public education – received a huge boost with passage of two citizen initiatives funneling nearly \$800 million over two fiscal years into reducing public school class sizes and increasing the salaries of teachers. In addition, the Legislature provided an additional \$85.7 million to fund smaller classes and extended learning opportunities in public schools.

Also approved was funding and legislation to provide focused assistance to low-performing schools, to continue a volunteer program to teach reading in schools, to make it easier for highly qualified citizens to teach in public school classrooms, to make schools safer, and to help school districts prevent bullying and harassment.

Higher Education

The Governor and the Legislature took two significant steps to improve the state's system of higher education. State funding of \$6 million was approved to match private contributions to start the Technology Institute at the University of Washington-Tacoma. The Institute will rapidly increase the number of graduates from the University's computing and software systems program, and also prepare high school and community and technical college students to enter the institute. Also approved was the expenditure of \$11.2 million to pay for "Promise Scholarships" to the top 15 percent of graduating high school students (or those who scored at least 1200 on the SAT), who also meet certain income criteria. Promise scholarships will help middle-income families pay the growing costs of a college education.

Economic Development

Efforts continued in 2001 to improve the ability of business to thrive in Washington. Governor Locke formed a "Competitiveness Council" comprising a broad cross section of state business and government leaders to examine tax and regulatory policies that might unnecessarily inhibit business activity. The goal is to address the identified problems in the 2002 legislative session.

The Governor and the 2001 Legislature also took steps to improve commerce in Washington. An additional \$93.6 million was provided to the Public Works Board to make loans to local governments to build facilities such as roads and water systems to attract economic development. The Governor also signed legislation to improve apprenticeship programs to create highly skilled jobs, and extended a program to allow minority and women owned businesses to apply for loans at a reduced interest rate.

Energy

Drought, rising power demand, California's turbulent energy market and the lack of new generating capacity all combined to tighten Washington's electricity supply in 2001. Several steps, including gubernatorial action and legislation, helped to ease the crunch and avoid severe economic disruption. Those steps ranged from the Governor declaring an "Energy Supply Alert" to permit more temporary power generation to passage of legislation to promote conservation and speed up construction of new generating plants. By year's end, the electricity market had stabilized, returning the cost of electricity to the levels before the energy crunch began in the spring of 2000.

Water and Salmon

Washington made important progress in 2001 on two vital and related issues – better management of the state's water resources and protection of its threatened wild salmon populations.

Governor Locke and the Legislature provided financing and legislation to make more efficient use of water for agriculture and salmon. These steps included a more flexible method to grant and transfer water rights; tax incentives to encourage water conservation and reuse; a method in which water rights holders can forego water use for the benefit of salmon and other users without losing their rights; and more local government participation in how water resources are used.

Quality Initiatives

Governor Locke continues a five-year-old drive to improve the way Washington State government does business. Since 1997, all Cabinet agencies have been required to have quality consultants on staff to encourage innovation by state employees and share successful initiatives with other agencies on a quarterly basis. The program has produced more than 1,940 quality projects that have saved the state more than \$77 million. Performance measures developed by agencies for key program activities are used as a part of the budget process. In addition, state agencies have completed a four-year program designed to review all state regulations, eliminate those that are unnecessary, and rewrite those that remain on the books in a manner more easily understood by the public. The regulatory improvement program has resulted in the elimination of over 4,600 rules, the rewriting of more than 5,200 regulations in plain English, simplified regulatory processes, and new Internet applications designed to make state government more accessible to citizens and businesses.

Other steps to improve the quality of state government included changes in retirement rules to slow the departure of experienced teachers and public employees; continued elimination of redundant and inefficient state boards and commissions; faster adoption of rules to implement new laws; and continued successes in putting more government services on the Internet.

Transportation Funding

Governor Locke and the Legislature made headway in 2001 in its multi-year drive to expand the state's transportation system to reduce congestion and serve a growing population. The two agreed on reforms and efficiencies to make the best use of transportation dollars and to speed up transportation projects. Improvements included cutting red tape in environmental permitting; allowing the same company to design and build a project; changing the vehicle identification inspection program to better use transportation funds; and speeding up right-of-way acquisitions. In addition, improvements were made to the state ferry system. The process was improved for designing and building new auto ferries, and state ferry fares were allowed to increase to the level needed. In addition, efficiencies were adopted to better perform ferry maintenance and preservation work.

Technology

Washington, home to many software industry leaders including Microsoft, continues to recognize the huge potential of information technology in revolutionizing the delivery of government services. Major progress in Washington State's technological development over the past year include:

- Increased use of the statewide K-20 Educational Telecommunications Network by state public education sectors including universities, community and technical colleges, and K-12 schools. Students and teachers continue to expand their use of network resources - Internet access, interactive video, and satellite-delivered distance learning services (refer to www.wa.gov/k20). K-20 Network participants were recently granted access to Internet2 (I2), the next generation Internet and its associated research and collaboration environment. Washington is one of only five states in which I2 access has been granted to all public education sectors.
- Continued efforts to expand the use of electronic payment options available to state agencies and their trading partners. The Office of the State Treasurer and the Department of Information Services have investigated and proven the viability of Internet-initiated checks. They are soliciting the private sector for an enterprise solution.
- Expansion of the state Web portal, Access Washington (www.access.wa.gov), to include a plain English search function called "Ask George," information on state, county, and city services, live round-the-clock customer support, and a secure gateway for the most sensitive transactions.

In addition, more than 300 digital government applications are available to serve Washington citizens and businesses -- from Internet car tab renewals, fishing and hunting licenses, and boat launch permits to master business licenses and online diabetes management. The continued innovations are reflected in consistent top rankings in 50-state comparisons of government use of technology in public service. Most recently, the National Association of State Chief Information Officers (NASCIO) recognized Washington's Digital Government Plan as the best plan in the country.

Welfare Reform

Despite a cooling economy, Washington State continued to make progress in moving citizens from welfare rolls to productive jobs. Enrollment in Washington's four-year-old WorkFirst Program fell by another 1,000 families, on top of several thousand over the previous three years. More importantly, an underlying cause of poverty – the number of children born into welfare – dropped by more than 50 percent in Washington because of successful family planning programs.

For the Future

Governor Locke will continue to pursue his three top priorities: Improving Washington's transportation and public education systems, and maintaining the state's strong financial position.

After laying solid political groundwork in 2001, the Governor will press the Legislature in 2002 for a package of measures to greatly expand Washington's system of roads, bridges and mass transit while, at the same time, creating thousands of construction jobs at a time of economic downturn.

The Governor will work to maintain major new short- and long-term investments to provide teachers and students with smaller classes and other benefits. He also will seek to make his Promise Scholarship Program, through which thousands of qualifying Washington high school students receive scholarships, a permanent program under the law.

The Governor also will continue to pursue expansion of programs to train and retrain workers needed to meet the increasing demand for high-technology skills.

Financial Information

Internal Controls

The state is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the state are protected from loss, theft, or misuse, and to ensure that adequate accounting data is compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. Internal accounting controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

Washington State continues to assess the adequacy of its internal control structure and make improvements where weaknesses are found. These actions will help assure that the state maintains public accountability for years to come.

Budgeting Controls

Budgetary control is maintained through legislative appropriations and the executive branch allotment process. The Governor is required to submit a biennial budget to the Legislature. The budget is legally required to be adopted through passage of appropriation bills by the Legislature with approval by the Governor. Appropriated funds are controlled by the executive branch through an allotment process. This expenditure plan details the appropriation into monthly estimates by program, source of funds, and object of expenditure. Nonappropriated governmental funds are also subject to allotment control by the executive branch. The state also maintains an encumbrance accounting system as one technique of accomplishing budgetary control. Encumbered amounts lapse at the end of the appropriation. However, capital encumbrances are generally reappropriated as part of the following biennial budget.

The state's budgetary policies and procedures, fund accounting structure, and basis of accounting are explained in detail in Note 1 to the financial statements.

Governmental Funds

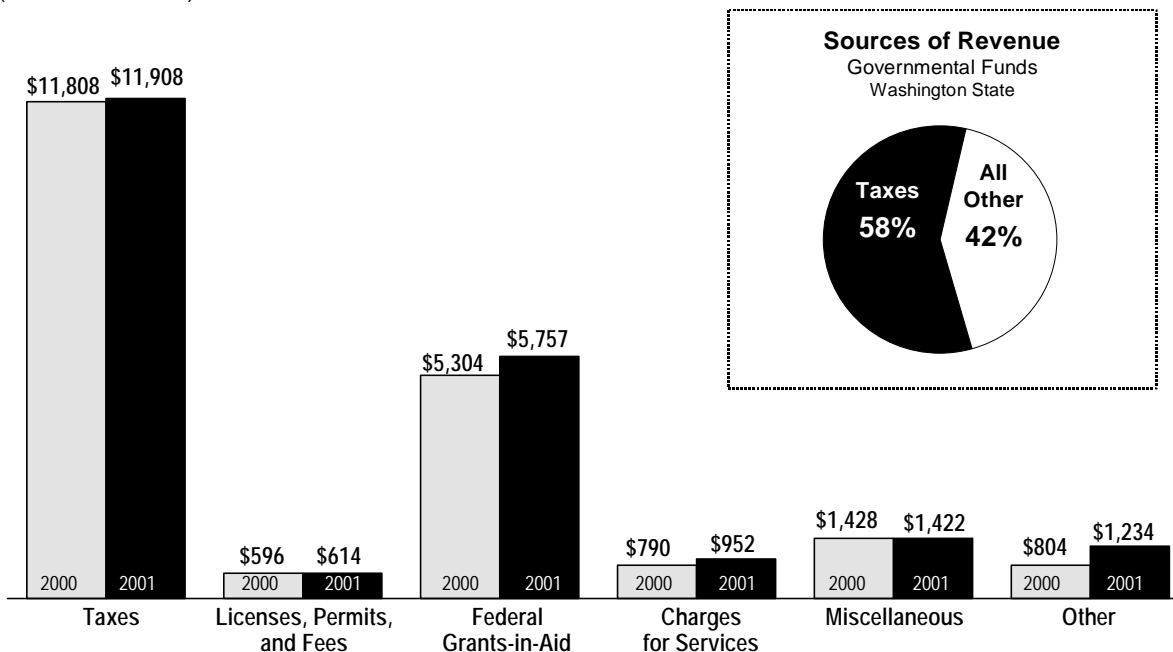
Governmental activities are accounted for in four governmental fund types: the general, special revenue, debt service, and capital projects funds. Revenues for governmental funds totaled \$20.7 billion for the fiscal year that ended June 30, 2001. This represents an increase of 3.6 percent over revenue for the fiscal year that ended June 30, 2000.

All Governmental Funds Revenues (dollars in millions)	Fiscal Year 2001		Fiscal Year 2000		Increase (Decrease) From 2000
	Amount	% of Total	Amount	% of Total	
Taxes	\$ 11,908	57.7%	\$ 11,808	59.3%	\$ 100
Licenses, Permits, and Fees	614	3.0%	596	3.0%	18
Federal Grants-in-Aid	5,757	27.9%	5,304	26.6%	453
Charges for Services	952	4.6%	790	4.0%	162
Miscellaneous Revenues	1,422	6.8%	1,428	7.1%	(6)
Total Revenues	20,653	100.0%	19,926	100.0%	727
Net Other Financing Sources (Uses)	1,234		804		430
Total Revenues and Other Sources (Uses)	\$ 21,887		\$ 20,730		\$ 1,157

Taxes, the largest source of governmental revenue, produced 58 percent of revenues. Although the percentage decreased slightly from Fiscal Year 2000, actual tax revenues increased by \$100 million. This increase is consistent with the growth in the state's population and personal income during Fiscal Year 2001, which increased retail sales tax collections by \$92 million.

All Governmental Funds - Revenues

For the Fiscal Years that ended June 30, 2000 and 2001
(dollars in millions)

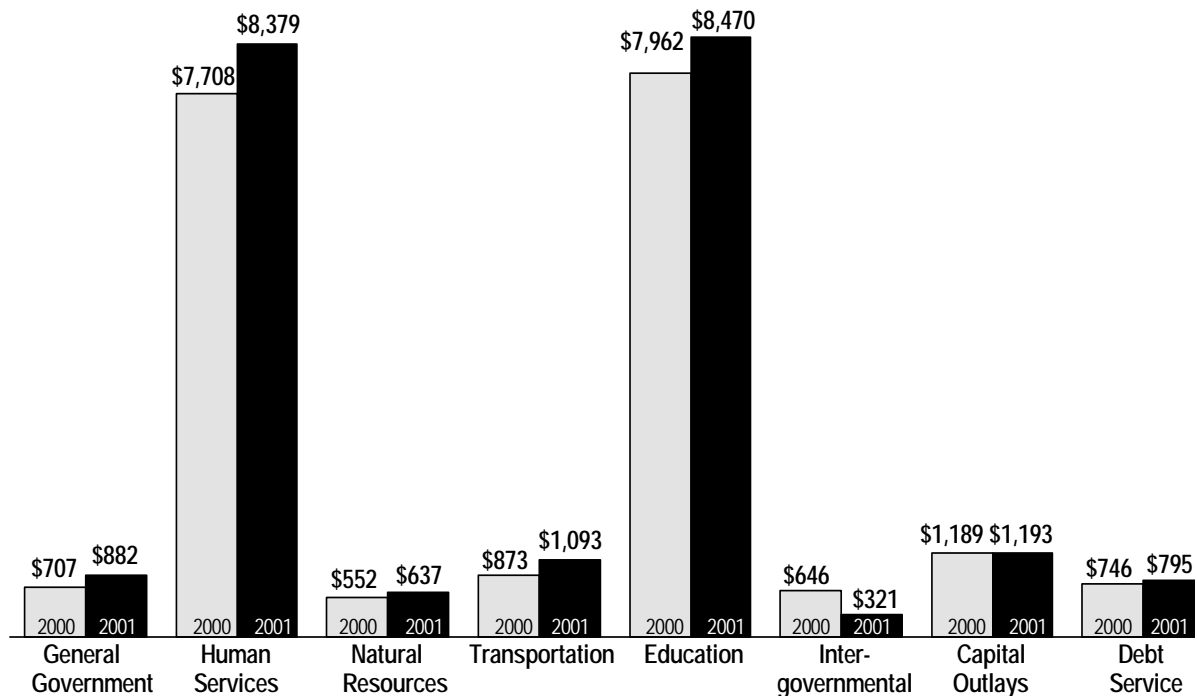


All Governmental Funds Expenditures (dollars in millions)	Fiscal Year 2001		Fiscal Year 2000		Increase (Decrease) From 2000
	Amount	% of Total	Amount	% of Total	
Current:					
General Government	\$ 882	4.1%	\$ 707	3.5%	\$ 175
Human Services	8,379	38.5%	7,708	37.8%	671
Natural Resources	637	2.9%	552	2.7%	85
Transportation	1,093	5.0%	873	4.3%	220
Education	8,470	38.9%	7,962	39.1%	508
Intergovernmental	321	1.5%	646	3.2%	(325)
Capital Outlays	1,193	5.5%	1,189	5.8%	4
Debt Service	795	3.6%	746	3.6%	49
Total Expenditures	\$ 21,770	100.0%	\$ 20,383	100.0%	\$ 1,387

In Fiscal Year 2001, demands continued to increase for education and certain human service programs, including medical assistance, job training, and child care for low income working families. Specifically, expenditures for human services increased \$597 million at the Department of Social and Health Services. Also, education expenditures increased by \$508 million with higher enrollments in local school districts and the state's colleges and universities. All expenditures for governmental activities totaled \$21.8 billion for the fiscal year that ended June 30, 2001, or a 6.8 percent increase over Fiscal Year 2000.

Expenditures - All Governmental Funds by Function

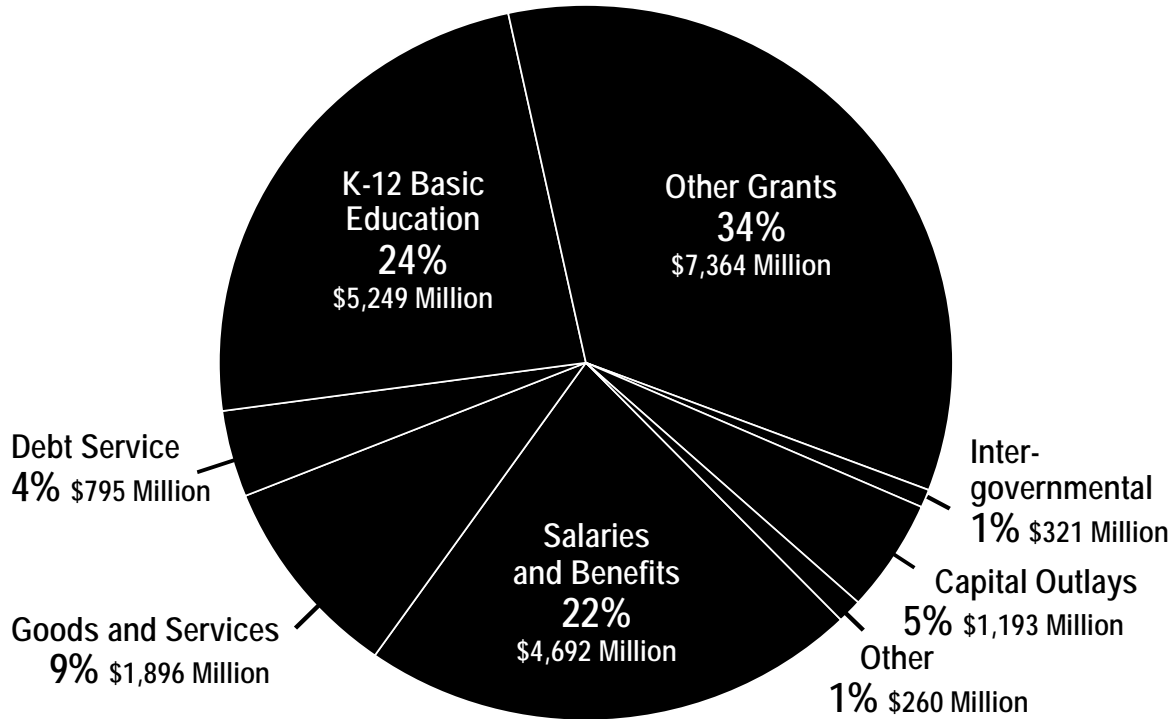
For the Fiscal Years that ended June 30, 2000 and 2001
(dollars in millions)



**Expenditures - All Governmental Funds
by Object**

For the Fiscal Year that ended June 30, 2001

TOTAL = \$21,770 Million



OFFICE OF FINANCIAL MANAGEMENT

DECEMBER 2001

Consistent with the functional distribution of costs, grants for K-12 education and other purposes are the major expenditures of governmental funds. The grants for K-12 education are apportioned to local school districts based primarily on student enrollment. The other grants are mainly public assistance payments and amounts passed through to other governments and nonprofit organizations.

General Fund

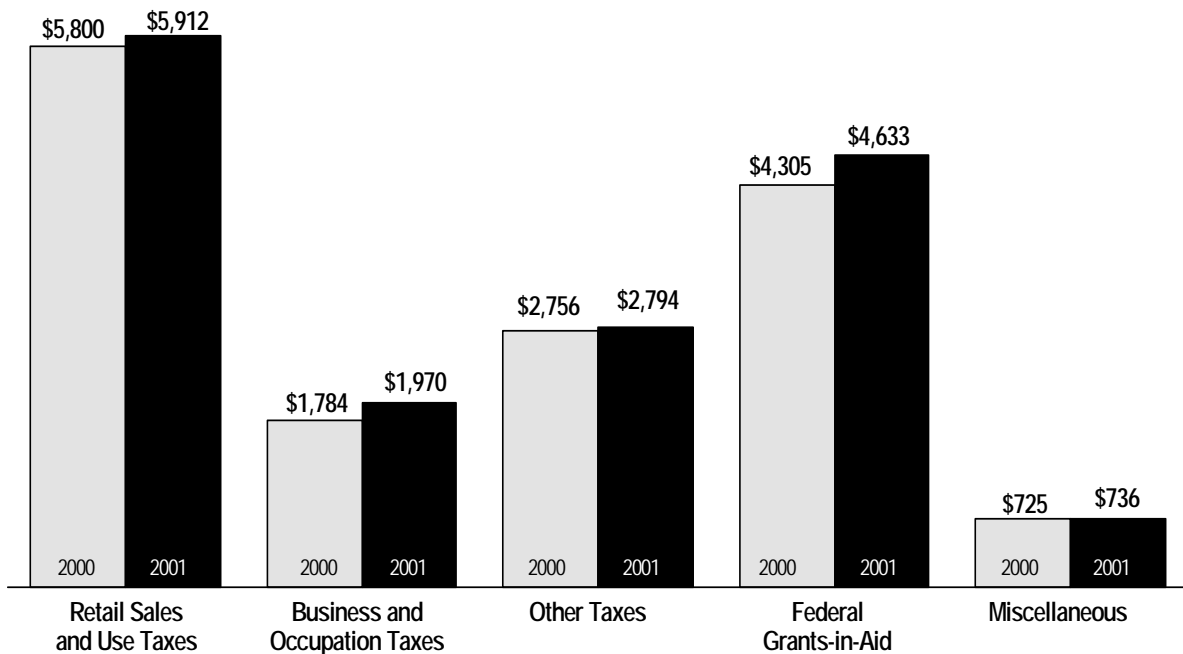
The General Fund accounts for all general government financial resources and expenditures not required to be accounted for in other funds.

General Fund Revenues (dollars in millions)	Fiscal Year 2001		Fiscal Year 2000		Increase (Decrease) From 2000
	Amount	% of Total	Amount	% of Total	
Retail Sales and Use Taxes	\$ 5,912	36.8%	\$ 5,800	37.7%	\$ 112
Business and Occupation Taxes	1,970	12.3%	1,784	11.6%	186
Other Taxes	2,794	17.4%	2,756	18.0%	38
Federal Grants-in-Aid	4,633	28.9%	4,305	28.0%	328
Miscellaneous Revenues	736	4.6%	725	4.7%	11
Total Revenues	\$ 16,045	100.0%	\$ 15,370	100.0%	\$ 675

Fiscal Year 2001 revenues in the General Fund increased by \$675 million or 4.4 percent. Retail sales and use taxes in the General Fund increased by \$112 million or 1.9 percent and federal grants-in-aid increased \$328 million or 7.6 percent. Retail sales and use taxes continue to be the largest source, amounting to 36.8 percent of General Fund revenues.

General Fund Revenues

For the Fiscal Years that ended June 30, 2000 and 2001
(dollars in millions)

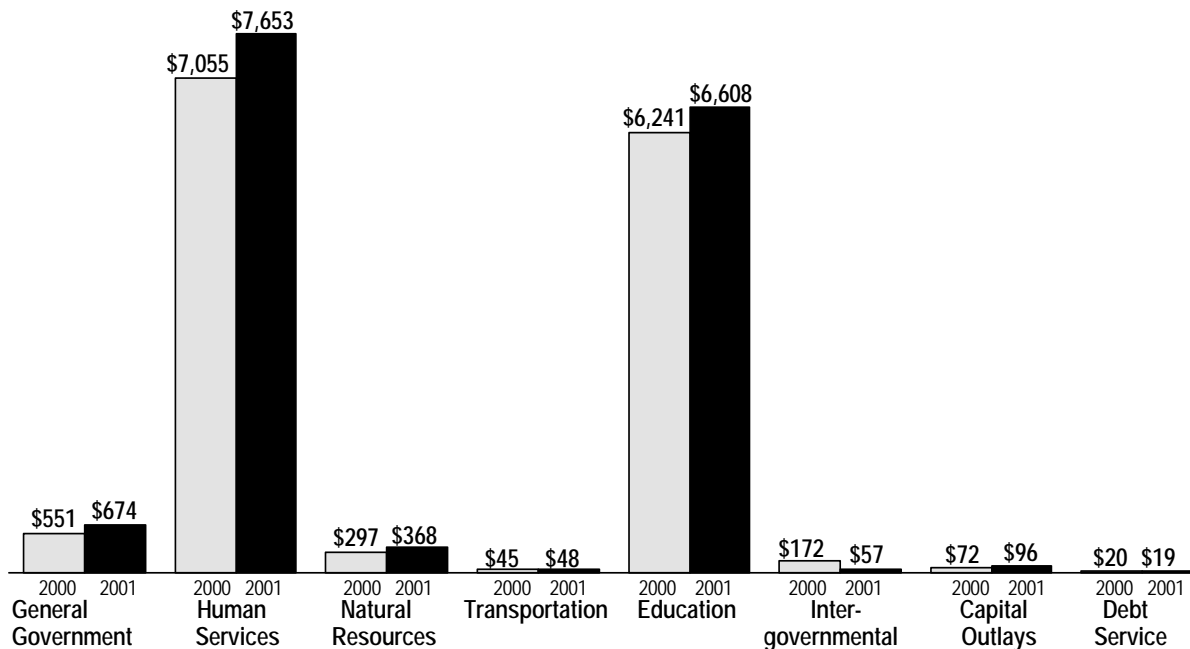


General Fund Expenditures (dollars in millions)	Fiscal Year 2001		Fiscal Year 2000		Increase (Decrease) From 2000
	Amount	% of Total	Amount	% of Total	
Current:					
General Government	\$ 674	4.3%	\$ 551	3.8%	\$ 123
Human Services	7,653	49.3%	7,055	48.8%	598
Natural Resources	368	2.4%	297	2.1%	71
Transportation	48	0.3%	45	0.3%	3
Education	6,608	42.6%	6,241	43.2%	367
Intergovernmental	57	0.4%	172	1.2%	(115)
Capital Outlays	96	0.6%	72	0.5%	24
Debt Service	19	0.1%	20	0.1%	(1)
Total Expenditures	\$ 15,523	100.0%	\$ 14,453	100.0%	\$ 1,070

Expenditures for General Fund activities total \$15.5 billion for the fiscal year that ended June 30, 2001, representing a 7.4 percent increase from Fiscal Year 2000. Of these expenditures, 42.6 percent went to support local school districts and higher education, and 49.3 percent was expended for human services. Expenditure increases in the General Fund parallel the increases in education and human services discussed earlier under All Governmental Funds.

General Fund Expenditures by Function

For the Fiscal Years that ended June 30, 2000 and 2001
(dollars in millions)



The fund balance of the General Fund, including all reserves and designations, totaled \$2.85 billion as of June 30, 2001, representing a decrease of \$84 million, from that of the previous fiscal year end.

The General Fund includes the reserve for the state's Emergency Reserve Fund that was created under the provisions of Initiative 601, approved by Washington voters in the November 1993 general election. Effective Fiscal Year 1996, Initiative 601 limits annual increases in General Fund-State (GF-S) expenditures to the average rate of inflation plus population growth for the previous three years. It also requires GF-S revenues in excess of the spending limit for any given year to be deposited in the Emergency Reserve Fund. For Fiscal Year 2001, the state was required to transfer \$9.2 million in GF-S revenues to the Emergency Reserve Fund. If the balance in the Emergency Reserve Fund exceeds 5 percent of biennial GF-S revenues, the excess is required to be deposited in the Education Construction Fund.

Since Fiscal Year 1996, the state has consistently held expenditures within the GF-S spending limit. Interest earnings on revenues transferred to the Emergency Reserve Fund accrue to that account.

Enterprise Operations

The state's enterprise operations are comprised of six separate and distinct activities ranging from operation of the Convention and Trade Center and the State Lottery to management of the State Workers' Compensation program. A brief description of each enterprise operation is presented in Note 18 to the financial statements.

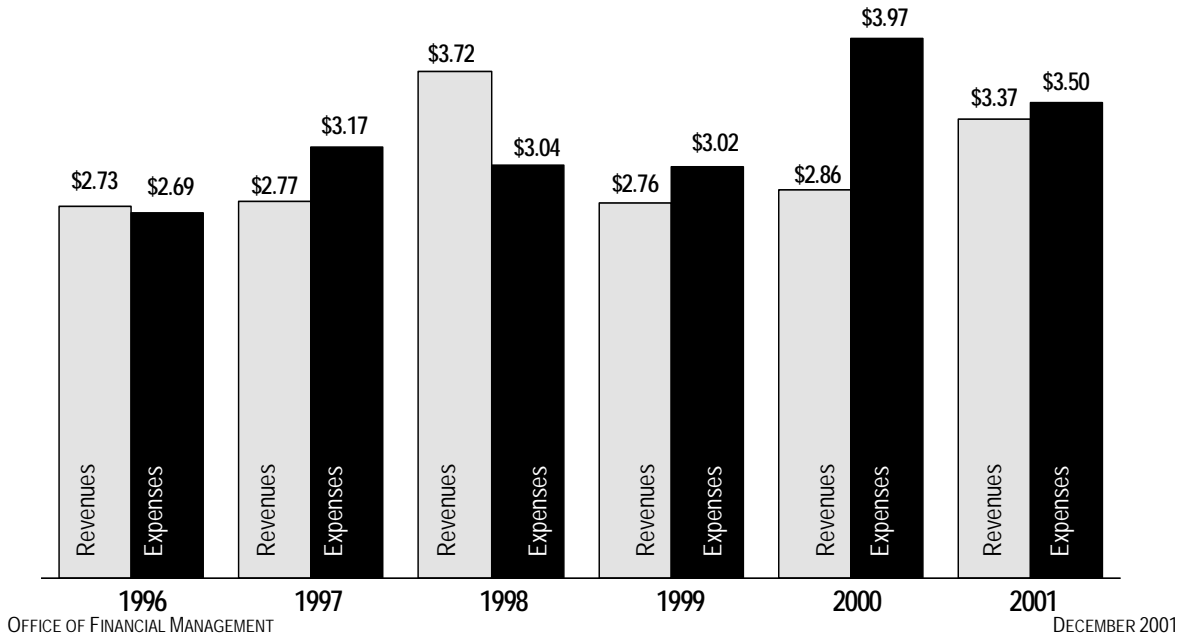
Combined operating and nonoperating revenues, including earnings (losses) on investments, for the state's enterprise funds increased from \$2.86 billion in Fiscal Year 2000 to \$3.37 billion in Fiscal Year 2001. This \$510 million increase is primarily due to increases in workers' compensation insurance premiums and earnings on investments. Combined enterprise activities' operating and nonoperating expenses decreased from \$3.97 billion in Fiscal Year 2000 to \$3.50 billion during Fiscal Year 2001. This \$470 million decrease is primarily due to a decrease in workers' compensation claims.

Outstanding enterprise fund bonds at June 30, 2001 totaled \$495 million. These bonds were issued primarily to provide construction funds for educational and convention facilities, and the Department of Labor and Industries building.

Enterprise Fund Operations

Revenues and Expenses

For the Fiscal Years that ended June 30, 1996 through 2001
(Billions of Dollars)



Retirement Systems

Valuations are performed for most of the state's pension systems on a calendar year basis. However, the Teachers' Retirement System (TRS) is on a fiscal year basis. At the close of Fiscal Year 2001, using results from the most recent actuarial valuations, the total actuarial value of investments in the state's pension trust funds reached \$45.1 billion. The latest Actuarial Accrued Liability was less than the value of assets available for benefits by \$605 million. The funding ratio for all funds combined was 105 percent.

Debt Administration

During Fiscal Year 2001, the state of Washington maintained its "AA+" rating from Fitch Investors Service and Standard & Poor's Ratings Group, and its "Aa1" rating from Moody's Investors Service. According to Fitch, "Washington's rating reflects several factors, including increasing diversification away from aerospace dominance, sustained economic growth that has produced very successful financial operations, and continuance of good debt and financial policies" (Fitch-NY-July 24, 2001).

The Office of the State Treasurer continued its administration of the state Lease-Purchase Program that has been in existence since Fiscal Year 1990. This program enables state agencies to realize substantial savings by financing the acquisition of real and personal property at tax-exempt interest rates. In the real estate component of the financing program, certain projects have been rated "Aa2" by Moody's Investors Service as a reflection of their essentiality to state government operations. On October 5, 2000,

Moody's Investors Service raised the rating on the equipment component of the program to "Aa2" from "Aa3". According to Moody's Investors Service, "the revised rating reflects the state's now well-established track record of making appropriation-backed debt payments ... the essentiality of the projects being financed" (October 5, 2000).

On September 1, 1998, the state Lease-Purchase program was extended to enable local governments to participate in low-cost financing of essential equipment [Local Option Capital Asset Lending Program (LOCAL)]. The program allows local participants to pool their financing requests together with Washington State agencies for lower tax-exempt interest rates, a rating of Aa2 from Moody's, and standardized documentation. The LOCAL program was authorized to begin financing real property for local governments on July 1, 2000. Since July 1, 2000, \$3.6 million in real estate projects have been financed for nine local agencies

As of June 30, 2001, there were \$506.2 million in outstanding certificates of participation. Underlying this amount were financing contracts in the amounts of \$487.7 for 57 state agencies and \$17.7 million for 104 local governments for a total of \$505.4 million. The balance of \$0.8 million represents unamortized costs of issuance. These programs are funded through public offering of certificates of participation by competitive bid.

During the 1999 legislative session, the Washington State Legislature passed Senate Joint Resolution 8206, effectively creating a Washington state school district credit enhancement program. The program's purpose is to provide savings to state taxpayers by pledging the full faith and credit of the state of Washington to the payment of voter-approved school district general obligation bonds.

The approved legislation carried two components: 1) a constitutional amendment to clarify that the state is pledging its full faith and credit to bonds issued under the program; and 2) implementing language for the guarantee program. Since the program authorization required a constitutional amendment, the proposed law was submitted to a vote of the electorate. Washington voters passed the constitutional amendment in November 1999 by a vote of 60 percent to 40 percent. The program is authorized in Chapter 39.98 RCW.

The School Bond Guarantee Program was developed under the direction of the State Treasurer. The State Treasurer convened an Advisory Group to assist in legal drafting, policy discussions, and legislative strategy. The Advisory Group included staff members from the Office of the State Treasurer, statewide school district representatives, assistant attorney general, bond lawyers and financial advisors. Administrative rules were entered into the Washington Administrative Code for program management.

The State Treasurer introduced the new school bond credit enhancement program in March 2000. The program was well accepted by schools across the state. At the end of fiscal year 2001, the state had guaranteed 52 school districts' voter-approved general obligation debt with a total outstanding principal of \$748.8 million.

During the past 17 years, the State Finance Committee has undertaken refunding operations to reduce interest costs on outstanding state indebtedness. Fiscal Year 2001 operations involved the sale of \$405.64 million various purpose general obligation tax-exempt refunding bonds, \$119.64 million motor vehicle fuel tax general obligation tax-exempt refunding bonds, and \$12.05 million various purpose general obligation taxable refunding bonds to refund bonds issued at average coupons of 5.384 percent to 6.447 percent. True interest costs on the refunding bonds ranged from 4.0441 percent to 6.2551 percent. Economic savings were achieved on the tax-exempt refunding transactions. Gross or nominal savings over the life of the refunded bonds was \$60.56 million, and present value savings were \$47.25 million -- a ratio of present value savings to new issue size of 8.793 percent. The taxable refunding was undertaken for the purpose of advance refunding and defeasing certain portions of the state's outstanding Various Purpose General Obligation Bonds, Series 1993A, 1994A, and 1994B (the "prior issues"), and, in connection with such refunding, providing the funds to pay a Closing Payment Amount to the Internal Revenue Service in respect of the prior issues. Over the course of the 17-year refunding effort, gross savings from all refunding transactions to date have amounted to \$454.60 million, or \$311.13 million on a present value basis.

Interest rates in the tax-exempt bond market continued to be attractive for long-term borrowing during Fiscal Year 2001. Over the fiscal year, \$807.92 million in new money general obligation and motor vehicle fuel tax general obligation bonds were sold in September 2000 (5.5207 percent, 5.5164 percent, and 6.8055 percent), and in January 2001 (5.0302 percent and 5.0263 percent). The rates for the \$196.4 million outstanding in adjustable rate general obligation bonds have varied between 1.55 percent and 5.60 percent, with an average rate of 3.6563 percentage for the Fiscal Year 2000.

Outstanding general long-term bonded debt as of June 30, 2001 totaled \$7.68 billion, an increase of 5.5 percent over June 30, 2000. Bonds were issued primarily for various capital projects throughout the state.

During Fiscal Year 2001, the state continued with its Selective Redemption Program, which takes advantage of a feature of the state's \$196.4 million outstanding variable rate debt that allows for selectively retiring any other higher cost long-term fixed rate debt in the state's portfolio. For Fiscal Year 2001, the Selective Redemption Program generated \$7.16 million in gross savings over the life of the bonds -- with present value savings of \$313,000.

The following table presents a summary of general obligation bonds issued during Fiscal Year 2001:

**State of Washington
General Obligation Bonds Issuances
Fiscal Year 2001**

Issue	Series / Date	True Interest Cost	Par Value
<i>September 19, 2000 Issue</i>			
<i>Various Purpose General Obligation Bonds</i>			
	Series 2001A.....	5.5207481%	\$ 279,525,000
<i>Motor Vehicle Fuel Tax General Obligation Bonds</i>			
	Series 2001B.....	5.5164233%	35,355,000
<i>General Obligation Bonds (State Housing Trust Fund)</i>			
	Series 2001T (Taxable).....	6.8054533%	26,770,000
<i>December 18, 2000 Issue</i>			
<i>Various Purpose General Obligation Refunding Bonds</i>			
	Series R-2001T (Taxable).....	6.2550611%	12,050,000
<i>January 23, 2001 Issue</i>			
<i>Various Purpose General Obligation Bonds</i>			
	Series 2001C.....	5.0301765%	295,075,000
<i>Motor Vehicle Fuel Tax General Obligation Bonds</i>			
	Series 2001D.....	5.0263257%	171,190,000
<i>May 22, 2001 Issue</i>			
<i>Various Purpose General Obligation Refunding Bonds</i>			
	Series R-2001A.....	4.0510853%	405,640,000
<i>Motor Vehicle Fuel Tax General Obligation Refunding Bonds</i>			
	Series R-2001B.....	4.0440718%	119,640,000
Fiscal Year 2001 Total			<u><u>\$ 1,345,245,000</u></u>

General obligation debt is subject to statutory limitations as prescribed by the Washington State Constitution and the Revised Code of Washington. For the fiscal year that ended June 30, 2001, the maximum debt authorization subject to limitation was \$5.41 billion. This does not include motor vehicle fuel tax debt, limited obligation debt, or reimbursable debt exempt from the statutory debt limit.

The ratio of general long-term debt to market value and the amount of bonded debt per capita are useful indicators of the state's debt position. These ratios as of June 30, 2001 are as follows:

	Dollars in Millions	Ratio of Debt to Market Value	Debt per Capita
General Long-Term Bonded Debt (Excluding Accreted Interest)	\$7,679	1.67%	\$1,290

Cash Management

State statutes provide that certain excess cash balances in the state treasury may be invested by the Office of the State Treasurer through the use of the Cash Management Account.

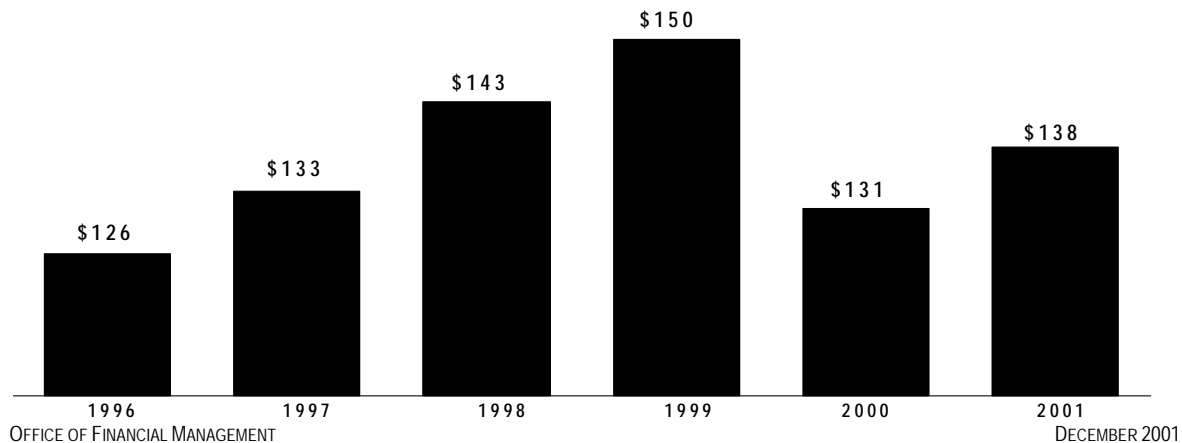
Investment transactions by the Office of the State Treasurer during Fiscal Year 2001 were limited to U.S. government and agency securities, repurchase agreements, securities lending, certificates of deposit with qualified public depositories, and commercial paper.

Total earnings for treasury funds from investment of the Cash Management Account balances for Fiscal Year 2001 were \$137.7 million, representing a 5.4 percent increase from Fiscal Year 2000. This increase resulted from a higher earnings rate which offset a slight decline in balances.

Earnings on Investments

Cash Management Account

For the Fiscal Years that ended June 30, 1996 through 2001
(Millions of Dollars)



Insurance Activities

The state has three insurance programs operated and accounted for as insurance businesses. Notes 1.L and 9 to the financial statements disclose the specific programs and claims liability changes during Fiscal Year 2001 for each insurance program.

Liabilities of the workers' compensation insurance activity amount to \$14.2 billion as of June 30, 2001. The liability includes \$6.98 billion for supplemental pension cost of living adjustments (COLA) that, by statute, are not to be fully funded. This COLA is funded on a pay-as-you-go basis, and the Department of Labor and Industries' actuaries have indicated that future premium payments will be sufficient to pay these claims as they come due. The remaining \$7.26 billion in claims liability is fully funded by long-term investments, net of obligations under securities lending agreements.

The risk management insurance activity liabilities amount to \$268.7 million as of June 30, 2001. This liability is currently unfunded.

State employees' insurance activities have liabilities as of June 30, 2001 amounting to \$43.1 million, which are fully funded with cash and investments, net of obligations under securities lending agreements.

Other Information

Independent Audit

State statutes require an annual audit by the Office of the State Auditor. The State Auditor is an independently elected public official. The state is also required to undergo an annual single audit in conformity with the provisions of the Single Audit Act of 1984 and U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.

The State Auditor conducts the audit of all state agencies. In addition to meeting the requirements set forth in state statutes, the audit was also designed to meet the requirements of the federal Single Audit Act. The Auditor's report on the general purpose financial statements is included in the financial section of this report. The Auditor's report related to the single audit, including the schedule of federal financial assistance, findings and recommendations, and reports on internal control structure and compliance with applicable laws and regulations, will be published in a separate report. Copies may be obtained from the Office of the State Auditor, Legislative Building, PO Box 40021, Olympia, Washington 98504-0021.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Washington State for its Comprehensive Annual Financial Report for the fiscal year that ended June 30, 2000. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized Comprehensive Annual Financial Report, with contents conforming to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. Washington State has received a Certificate of Achievement for the last fourteen years. The Office of Financial Management considers this report to be in conformance with the Certificate of Achievement Program requirements, and will submit it to the GFOA.

Acknowledgment

The preparation of this report could not have been accomplished without the professionalism and dedication demonstrated by the financial and management personnel of each state agency and institution of higher education, and the Office of Financial Management.

This Comprehensive Annual Financial Report reflects the commitment of the Governor to the Legislature, the citizens of Washington State, and the financial community to maintain financial statements in conformance with the highest standards of financial accountability.

Sincerely,

A handwritten signature in black ink that reads "Marty Brown". The signature is written in a cursive, flowing style.

Marty Brown
Director